Supreme Court of the United States

OCTOBER TERM, 1958

No. 579

UNITED STATES, PETITIONER,

vs.

DURHAM LUMBER CO., ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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[fol. 1] **IN THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT**

UNITED STATES OF AMERICA, PETITIONER

v.

DURHAM LUMBER COMPANY, a Corporation, and GEORGE H. CARTER, JR., Formerly Trading as DIXIE CONCRETE AND SUPPLY COMPANY

APPENDICES TO BRIEF FOR THE CLAIMANT-APPELLANT

[fol. 2] IN UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF NORTH CAROLINA, AT GREENSBORO

APPENDIX A

Internal Revenue Code of 1954:

SEC. 6321. LIEN FOR TAXES.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

(26 U.S.C. 1952 ed., Supp. II, Sec. 6321.)

SEC. 6322. PERIOD OF LIEN.

Unless another date is specifically fixed by law, and the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed is satisfied or becomes unenforceable by reason of lapse of time.

(26 U.S.C. 1952 ed., Supp. II, Sec. 6322.)

SEC. 6323. VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS.

(a) *Invalidity of Lien Without Notice.*—Except as otherwise provided in subsection (c), the lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Secretary or his delegate—

(1) *Under State or Territorial Laws*—In the office designated by the law of the State or Territory in which property subject to the lien is situated, whenever the State or Territory has by
[fol. 3] law designated an office within the State or Territory for the filing of such notice; or

(2) *With Clerk of District Court.*—In the office of the clerk of the United States district court for the judicial district in which the property subject to the lien is situated, whenever the State or Territory has not by law designated an office within the State or Territory for the filing of such notice; * * *

* * * *

(26 U.S.C. 1952 ed., Supp. II, Sec. 6323.)

General Statutes of North Carolina (Recompiled 1950):

SEC. 44-1. On buildings and property, real and personal.—Every building built, rebuilt, repaired or improved, together with the necessary lots on which such building is situated, and every lot, farm, or vessel, or any kind of property, real or personal, not herein enumerated, shall be subject to a lien for the payment of all debts contracted for work done on the same, or material furnished.

SEC. 44-6. Lien given subcontractors, etc., on real estate.—All subcontractors and laborers who are employed to furnish or who do furnish labor or material for the building, repairing or altering any house or other improvement on real estate, have a lien on said house and real estate for the amount of such labor

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done or material furnished, which lien shall be preferred to the mechanic's lien now provided by law, when notice thereof shall be given as hereinafter provided, which may be enforced as other liens in this chapter, except where it is otherwise provided; but the sum total of all the liens due subcontractors and [fol. 4] materialmen shall not exceed the amount due the original contractor at the time of notice given.

Sec. 44-8. Statement of contractor's indebtedness to be furnished to owner; effect.—When any contractor, architect or other person makes a contract for building, altering or repairing any building or vessel, or for the construction or repair of a railroad, with the owner thereof, it is his duty to furnish to the owner or his agent, before receiving any part of the contract price, as it may become due, an itemized statement of the amount owing to any laborer, mechanic, or artisan employed by such contractor, architect or other person, or to any person for materials furnished, and upon delivery to the owner or his agent of the itemized statement aforesaid, it is the duty of the owner to retain from the money then due the contractor a sum not exceeding the price contracted for, which will be sufficient to pay such laborer, artisan or mechanic for labor done, or such person for material furnished, which said amount the owner shall pay directly to the laborer, mechanic, artisan or person furnishing materials. The owner may retain in his hands until the contract is completed such sum as may have been agreed on between him and the contractor, architect or other person employing laborers, as a guaranty for the faithful performance of the contract by such contractor. When such contract has been performed by the contractor such fund reserved as a guaranty shall be liable to the payment of the sum due the laborer, mechanic or artisan for labor done, or the person furnishing the materials as hereinbefore provided.

Sec. 44-9. Subcontractors, laborers and materialmen may notify owner of claim; effect.—Any subcontractor, laborer, mechanic, artisan, or person fur-

[fol. 5] nishing materials, who claims the lien provided for in this article for labor on, or materials furnished for, any building, vessel, railroad, or real estate, may give notice to the owner, agent or lessee who makes the contract for the labor or materials, of the amount due by the contractor to such claimant. The notice shall be in the form of an itemized statement of the amount due, except where the contract is entire for a gross sum and cannot be itemized. Upon the delivery of the notice to the owner, agent, or lessee, the claimant is entitled to all the liens and benefits conferred by law in as full a manner as though the statement were furnished by the contractor. If the said owner, agent or lessee refuses or neglects to retain, out of the amount due the contractor under the contract a sum not exceeding the price contracted for which will be sufficient to pay such claimant, then the claimant may proceed to enforce his lien, and after such notice is given no payment to the contractor shall be a credit on or a discharge of the lien herein provided for.

SEC. 44-38. Claim of lien to be filed; place of filing. —All claims against personal property, of two hundred dollars and under, may be filed in the office of the nearest justice of the peace; if over two hundred dollars or against any real estate or interest therein, in the office of the superior court clerk in any county where the labor has been performed or the materials furnished; but all claims shall be filed in detail, specifying the materials furnished or labor performed, and the time thereof. If the parties interested make a special contract for such labor performed, or if such material and labor are specified in writing, in such cases it shall be decided agreeably to the terms of the contract, provided the terms of such

[fol. 6] contract do not affect the lien for such labor performed or materials furnished.

SEC. 44-43. Action to enforce lien.—Action to enforce the lien created must be commenced in the court of a justice of the peace, and in the superior court,

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according to the jurisdiction thereof, within six months from the date of filing the notice of the lien. But if the debt is not due within six months, but becomes due within twelve months, suit may be brought or other proceedings instituted to enforce the lien in thirty days after it is due.

[fol. 7] IN THE UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF NORTH CAROLINA

APPENDIX B

In Bankruptcy No. 1918

IN THE MATTER OF AUBREY H. MICHAEL & EDWARD L. EMBREE, JR., IND. AND T/A MICHAEL & EMBREE, CONTRACTORS

MINUTES OF THE FINAL MEETING OF CREDITORS

Bankrupt:

The final creditors meeting in the above case was duly held at the time and place as designated in the Notice to Creditors at which time there were present the Referee, the Trustee and interested parties.

The Report of the Trustee was made available for the inspection and examination of the creditors and there were no objections made to said report.

The following fees and expenses were found to be fair and reasonable and approved and directed to be paid as follows:

Herman A. Smith, U. S. Clerk costs as per separate order	$	718.48
W. Hance Hofler, Trustee's fee	$	461.29
....., Trustee's expenses	$	.....
Daniel K. Edwards (This includes $1,200.00 allocated in the lien order), Attorney for Trustee, fee	$	3,000.00
Expense of Trustee's Attorney	$	.....
Rufus W. Reynolds, advanced for telephone calls	$	7.88
Rufus W. Reynolds, travel expenses advanced	$	.....
E. K. Powe, Attorney for Bankrupt, fee	$	400.00
Daniel K. Edwards, Attorney for Petitioning Creditors, fee	$	200.00
....., Attorney for Petitioning Creditors, expenses	$	.....
Bank of Greensboro, N. C. Intangible tax for current year	$	10.41
Office Service Company, Preparing notices, etc. for Referee, special work	$	6.10
Charles W. White, State Receiver	$	300.00
Total	$	5,104.16

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[fol. 8] It appeared that there was a balance on hand of..... $13,884.91
After paying the above expenses there will be a balance of.. $ 8,780.75
to be applied as far as it will go in the following order:

Wages as follows:		
Pfd. Claim No. 10 J. W. Thames	$200.00	
Pfd. Claim No. 11 J. W. Thames	52.84	
		252.84
Adams Concrete Company	135.00	
Nolan Company	330.65	
(arising out of obtaining judgment against McArthur & Chambers, see order below)		465.65
Director of Internal Revenue—lien as filed in Durham County, on Nov. 2, 1954		4,017.53
Director of Internal Revenue—withholding and FICA assessment date Nov. 22, 1954—lien (not filed in Durham County)		3,254.73

Material Claims Which are Liens on Chambers-McArthur Judgment after Director of Internal Revenue Lien

Claimant	Amt. of Claim	20% Dividend	
Durham Brazing & Welding Company	360.78	14.68	
Dixie Concrete & Supply Company	3,088.54	639.36	
Durham Lumber Company	364.93	75.96	
	3,816.25		790.00
			$8,780.75

ORDER

Upon the petition of certain material furnishers and the claims by the Director of Internal Revenue, and after hearing the evidence, the argument of counsel, and consideration of briefs, the following facts and conclusions of law are made:

1

The bankrupts were general contractors doing business in and around Durham, North Carolina. They filed a voluntary petition in bankruptcy on January 3, 1955, and were adjudicated bankrupts on January 18, 1955.

2

That during the first part of 1954 the bankrupts entered into a contract to build certain camp buildings for G. T. McArthur and R. L. Chambers, hereinafter

[fol. 9] referred to as "Owners". The buildings were completed on July 15, 1954. At the date of bankruptcy there was an unpaid balance of $5250.00 due from the Owners to the bankrupts on the said contract. However, the Owners disputed the amount and contended that there was nothing due.

3

The Trustee instituted suit against the Owners in the Superior Court of Durham County, North Carolina, and finally won a jury verdict of $5250.00. The judgment on the verdict was entered on June 7, 1956. Shortly after the judgment was rendered the owners petitioned the bankrupt court for permission to pay certain material furnishers or subcontractors of the bankrupts who had given the owners notice of furnishing such material. At that time it appeared to the Owners that they had failed to include in the action or join as parties in the Trustee's action the alleged subcontractors of the bankrupt. Adams Concrete Company and Nolan and Company had already instituted suits against the Owners. These two suits were not combined with the Trustee's suit.

4

Extensive negotiations went on between the Trustee, the material furnishers and the Owners. Finally the Owners made a motion in the Superior Court to reopen the proceeding and make parties the alleged material furnishers. Nolan and Company filed a petition in the bankruptcy court for permission to make the Trustee a party to its action. Finally in Superior Court in order to get the judgment and matters settled the Trustee marked out an agreement and obtained permission of the bankruptcy court to compromise and settle the Nolan claim in the original amount of $741.25 [fol. 10] for the sum of $300.00 plus $30.45 court costs, and settle the suit involving the Adams Concrete and Block Company which was in the original amount of $228.63 for $123.00 plus $10.00 court costs, with the understanding that this amount would be paid from the judgment collected from Chambers & McArthur. After this agreement was entered, then the Owners voluntarily

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paid the judgment in the amount of $5250.00 plus $250.00 interest. It was understood that the parties who might be entitled to this fund would be determined in the bankruptcy court the same as if they were in the Superior Court. The Director of Internal Revenue was never party to any of those three actions.

5

The Durham Brazing & Welding Company whose claim is in the amount of $360.70 gave notice to the Owners of its claim on June 20, 1955. The Dixie Concrete & Supply Company whose claim is $3,089.54, gave notice to the Owners on January 12, 1955. The Durham Lumber Company, whose claim is in the amount of $366.93, gave notice in February, 1955. The other subcontractors and material furnishers claiming a lien did not give any notice. They are as follows: Genn Hosiery Mill, $374.15; Gwalney Oil Company, $334.64; Lovett Electric Company, $437.50; Nello L. Teer Company, $355.07; Peedan Steel Company, $820.29.

6

The Director of Internal Revenue claims a lien on the amount collected from the Owners as well as a lien on the other assets of the bankrupts by reason of withholding and F. I. C. A. taxes assessed August 13, 1954, filed in the Register of Deeds Office of Durham County on the 2nd day of November, 1954, on which there is a present balance due of $4,017.53 and a tax claim for [fol. 11] withholding and F. I. C. A. assessed November 22, 1954, in the amount of $3254.73. The Trustee and his attorney spent several days in trying, arguing and collecting the judgment from the Owners. Reasonable compensation which the attorney for the Trustee earned is found to be $1200.00. The bankruptcy court costs on the amount recovered is 2%, and the Trustee's commission is 2%, making a total cost of $1420.00 which should be allocated and paid from the judgment. This allocation and expense is included in the above attorney's fee and Trustee's fee and court costs.

Conclusions of Law

7

The $135.00 compromise and agreement with Adams Concrete and Block Company and the $330.63 compromise with Nolan and Company was legal and necessary and was part of the costs of procuring the settlement and judgment and that this sum should be first taken from the amount of the judgment. After then deducting the costs of obtaining the judgment, the Director of Internal Revenue has a lien prior to the liens as claimed by the Durham Brazing & Welding Company, Dixie Concrete and Supply Company and the Durham Lumber Company which position is supported by the following cases:

U. S. v. The White Bear Brewing Co., 350 U. S. 1010 (1956)
U. S. v. Collatta (1955) 350 U. S. 800
U. S. v. Kings County Iron Works, Inc., (C.A. 2nd 1955) 224 Fed. 232
Brust v. Starr (C.A. 2nd 1956) 237 Fed. 2nd 135
United States v. England (C.A. 9th 1955) 226 Fed. 2nd 205
United States v. City of New Brittain (1953) 347 U. S. 81

8

[fol. 12] The material and subcontract claimants who did not file any notice with the Owners are not entitled to any liens on any proceeds of the judgment by reason of the fact that such notice must be given pursuant to the statutes of North Carolina before any lien is created or any right to any funds in the hands of the Owners is established.

Wherefore, It Is Ordered that after the application of the balance of the funds on hand to the lien by the Director of Internal Revenue, the unpaid balance of the liens as above computed in the minutes of the final creditors meeting be paid from the judgment from McArthur & Chambers and that the remainder after deducting the said liens by the Director of Internal Revenue be paid prorata on the claims of Durham Brazing & Welding Company, Dixie Concrete & Supply Company, and Durham Lumber Company as above indicated.

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IT IS FURTHER ORDERED that the claimants as subcontractors and material furnishers who did not file any notice with the Owners are not entitled to any liens on any of the proceeds.

This the 22 day of August, 1957.

(S.) RUFUS W. REYNOLDS,
Referee in Bankruptcy.

• • • •

CERTIFICATE BY REFEREE TO JUDGE

I, Rufus W. Reynolds, Referee of said Court, do hereby certify that in the course of proceeding in the said cause [fol. 13] before me, upon the hearing of claims of liens by material furnishers and subcontractors of the Bankrupt and the Director of Internal Revenue as to the amount, validity and priority, the following question was presented:

> "Where Trustee for general contractors recovers balance due on construction contracts and the Director of Internal Revenue assesses taxes against the Bankrupt before bankruptcy and before subcontractors of the Bankrupt give notice of lien to Owners, who has prior lien, Director of Internal Revenue or subcontractors?"

Upon considering the evidence I made findings as set out in the order as attached hereto. Said findings were made after considering the testimony, documentary evidence and argument of counsel.

WHEREUPON, on the 22nd day of August, 1957, I entered an order allowing the lien by the Director of Internal Revenue Senior to the subcontractors' liens, first satisfying the Director's liens from other assets in the bankrupts' estate.

WHEREUPON, petitions for review of said order by the Judge were filed by George H. Carter, Jr., formerly trading as Dixie Concrete and Supply Company, and Durham Lumber Company.

Attached to this certificate are the following documents:

1. Petition for Review by George H. Carter, Jr., formerly trading as Dixie Concrete and Supply Company.
2. Petition for Review by Durham Lumber Company.
3. Petition by Chambers & McArthur to compromise judgment and apply payments on judgment.
4. Petition by Noland Company, Inc., to join Trustee as party in action.

[fol. 14] 5. Order approving compromise with Noland Company, Inc., and Adams Concrete Company.

6. Petition by Trustee to give material claimants notice to establish claims.
7. Order by Referee dated July 1, 1957, directing alleged material furnishers to establish liens.
8. Service of notice on alleged claim holders.
9. Notice to all creditors and alleged lien holders of hearing on claims for lien.
10. Proceedings of the action in State Court by Trustee against G. T. McArthur and R. L. Chambers.
11. Claims of liens as filed by:
    - (A) Durham Brazing and Welding Works
    - (B) Pedra Steel Company
    - (C) Lovette Electric Construction Company
    - (D) Nello L. Teer Company
    - (E) Durham Lumber Company
    - (F) George H. Carter, Jr., formerly trading as Dixie Concrete and Supply Company

12. Briefs as filed by:
    - (A) U. S. Treasury Department
    - (B) Durham Brazing and Welding Works

13. Letter from E. K. Powe, Attorney for the Bankrupt.
14. Letter from Daniel K. Edwards, Attorney for the Trustee.
15. Order entered by Referee, dated August 22, 1957, determining priority and amount of claim. (The order is combined with final distribution of funds on hand in order that a picture of the entire matter can be ascertained.)

This the 4 day of September, 1957.

(S.) Rufus W. Reynolds,
Referee in Bankruptcy.

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[fol. 15] MEMORANDUM OPINION—October 14, 1957

HAYES, District Judge:

Exceptions to the order of the Referee in Bankruptcy were filed by Geo. H. Carter, Jr. formerly trading as Dixie Concrete and Supply Co., and Durham Lumber Co., in so far as the order gave the United States tax lien priority over them.

The Referee applied the doctrine of priority usually applicable to the distribution of assets belonging to the bankrupt and relied primarily on *United States* v. *White Bear Brewing Co.*, 350 U.S. 1010, reversing 7th Circuit in 227 Fed. 2d 359. There the bankrupt was the owner of real property which had been improved by a person asserting a mechanic's lien. Priority of liens as between the United States and such a claimant for a mechanic's lien was the issue determined.

In the instant case the owner is not the bankrupt; the contractor is the bankrupt. It is therefore necessary to determine whether the asset in question was the sole property of the bankrupt before the *White Bear* case, *supra*, applies.

The contractor (bankrupt) agreed to furnish and pay for all labor and materials and erect the improvement for a stated sum, free from all liens against the property.

When the contractor was adjudged a bankrupt, the work had been completed and a balance was due the contractor if the labor and materialmen's liens were discharged.

The trustee sued the contractor and obtained a judgment for the balance of the contract price. However, the two excepting creditors gave the statutory notice to the owner of the amounts due them by the contractor for labor and materials furnished by them in the performance of the contract. They did all required of [fol. 16] them to establish a valid lien against the property of the owner—not the bankrupt contractor.

After the trustee obtained a judgment against the owner but before paying the judgment, the Superior Court, rendering the judgment, made an order, pursuant to the law of North Carolina, *Swiggins* v. *Buss Co.*, 230

N.C. 234, making these lien claimants parties to the original action. That court, with all the parties before it, required the defendant owner to pay over to the trustee the balance due, and transferred the liens to the fund and discharged the owner from their claims. The state court permitted the fund to come into the hands of the trustee impressed with such liens thereon as the claimants possessed, to be determined by the bankruptcy court. It was not provided in the order or implied in it, that the funds was an asset of the bankrupt free from the liens of these claimants.

Since the state court discharged the owner from these claims and transferred the liens to the funds, it follows that the fund in the possession of the trustee is subject to whatever valid liens existed at the time of the transfer. Under the law of North Carolina, where a laborer, materialman or subcontractor gives the required statutory notice to the owner his lien immediately attaches to any balance due by the owner to the original contractor, and payment to the contractor thereafter will not discharge the owner from the lien of such a claimant. The fund was required by the law of North Carolina to be applied first in discharge of these liens before it became an asset of the bankrupt contractor. *Schnepp* v. *Richardson*, et al., 222 N.C. 228; *Assurance Society* v. *Basnight* et al., 234 N.C. 347.

The usual order of distribution of the assets of a bankrupt undoubtedly controls the disposition of assets owned by the bankrupt but can not be enlarged to include assets not belonging to the bankrupt. *Fidelity and Deposit Co.* v. *New York City Housing Authority*, [fol. 17] 241 F. 2d 142 2d cir. 0. The exceptions are allowed and the order of the Referee is modified accordingly.

This the 14 day of October 1957.

(S.) JOHNSON J. HAYES,
United States District Judge.

Exception allowed to the United States October 14, 1957.

HAYES,
Judge.

* * * *

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NOTICE OF APPEAL

Notice is hereby given that the United States of America hereby appeals to the United States Court of Appeals for the Fourth Circuit from the Memorandum Opinion of Honorable Johnson J. Hayes dated October 14, 1957, modifying the order of the Referee and reversing the same insofar as said order of the Referee gave certain tax liens of the United States of America priority over the claims filed by George H. Carter, Jr., formerly trading as Dixie Concrete and Supply Company, Durham Lumber Company, and Durham Brazing and Welding Company.

(S.) ROBERT L. GAVIN,
United States Attorney,
314 Post Office Building,
Greensboro, North Carolina.

(S.) LAFAYETTE WILLIAMS,
Assistant United States Attorney.

• • • •

[fol. 19] **APPENDICES TO BRIEF FOR THE CLAIMANT-APPELLEES**

[fol. 20] IN UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF NORTH CAROLINA, AT GREENSBORO

APPENDIX A

General Statutes of North Carolina 1943 (as amended and recompiled) G.S. 44.

Sec. 44-10. *Sums due by statement to constitute lien.*

The sums due to the laborer, mechanic or artisan for labor done, or due the person furnishing materials, as shown in the itemized statement rendered to the owner, shall be a lien on the building, vessel, or railroad built, altered, or repaired, without any lien being filed before a Justice of the Peace or the Superior Court.

Sec. 44-11. *Where sums due contractor from owner insufficient payment pro rata.*

If the amount due the contractor by the owner is insufficient to pay in full the laborer, mechanic, or artisan, for his labor, and the person furnishing materials, for materials furnished, it is the duty of the owner to distribute the amount pro rata among the several claimants, as shown by the itemized statement furnished the owner, or of which notice has been given the owner by the claimant.

Sec. 44-12. *Contractor failing to furnish statement, or not applying owner's payments to laborer's claims, misdemeanor.*

If any contractor or architect shall fail to furnish to the owner an itemized statement of the sums due [fol. 21] to every one of the laborers, mechanics, or artisans employed by him, or the amount due for materials, before receiving any part of the contract price, he shall be guilty of a misdemeanor. If any

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contractor shall fail to apply the contract price paid him by the owner or his agent to the payment of bills for labor and material, he shall be guilty of a misdemeanor and upon conviction thereof shall be fined or imprisoned, or both, at the discretion of the court.

[fol. 22] APPENDIX B

IN THE SUPERIOR COURT
FOR DURHAM COUNTY,
NORTH CAROLINA

APRIL-MAY CIVIL TERM

W. HANCE HOFLER, TRUSTEE IN BANKRUPCY, FOR AUBREY H. MICHAEL AND EDWARD L. EMBREE, JR., INDIVIDUALLY, AND TRADING AS MICHAEL & EMBREE, CONTRACTORS

v.

G. T. MCARTHUR AND R. L. CHAMBERS, ORIGINAL DEFENDANTS, AND GEORGE H. CARTER, JR., TRADING AS THE DIXIE CONCRETE SUPPLY COMPANY; DURHAM LUMBER COMPANY, ET ALS.

ORDER

THIS MATTER coming on to be heard upon the written verified Motion of the defendants, G. T. McArthur and R. L. Chambers, for leave to file a Supplemental Answer and Bill of Interpleader and to make certain persons, firms, and corporations additional parties defendant in this action, and the said Motion having been duly and carefully considered and the Court being of the opinion that the said defendants, McArthur and Chambers, are entitled to file a Supplemental Answer and Bill of Interpleader and to have said persons made additional parties defendant in this action; it is now, therefore,

ORDERED that the said G. T. McArthur and R. L. [fol. 23] Chambers be and they are hereby permitted and granted leave to file a Supplemental Answer and Bill of Interpleader in this matter; and it is

FURTHER ORDERED that George H. Carter, Jr., trading as the Dixie Concrete Supply Company; Durham Lumber Company, Incorporated; Durham Brazing & Welding Works; Gann Hosiery Mills, Inc. Noland

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Company, Incorporated; R. D. Adams, F. H. Adams, P. F. Adams, Jr., and J. D. Adams, trading and doing business as Adams Concrete Products Company; J. R. Bagwell Company, a corporation; C. V. Brown and W. L. Brown, Jr., trading as Brown Brothers Plumbing & Heating Company; Carolina Block Company; Carolina Steel & Iron Company, a corporation; W. B. Connelly; Cowan & Mitchell Lumber Company, a corporation; Cowan Construction Co., Inc., L. H. Mount, Receiver for Cowan Construction Co., Inc.; Lovette Electric Construction Company, a corporation; Peden Steel Company, a corporation; Arthur F. Perkins, Jr., trading as Perkins Glass Company; Public Hardware, Incorporated; Nello L. Teer Company, Inc.; Walton Roofing & Heating Company, Incorporated; Morgan Lee; Coley Laws; Hydra S. Best, trading as Best Plumbing Company; Fuquay-Varina Builders Supply; D. W. Jackson; and E. G. Belvin, Sheriff of Durham County, be and they are hereby made additional parties defendant in this action; and Summons will issue for said additional defendants from the Office of the Clerk of the Superior Court of Durham County; and it is

[fol. 24] FURTHER ORDERED that a copy of the Supplemental Answer and Bill of Interpleader be served along with the Summons on each of the said additional defendants and that a copy of the Motion and Order likewise be served upon said additional defendants, and that they be required to answer the Supplemental Answer and Bill or Interpleader within thirty (30) days after service thereof, or the relief prayed for will be granted.

This the 3rd day of May, 1957.

(signed) CLAWSON L. WILLIAMS
Judge Presiding Over The Superior Court of Durham County

[fol. 24a] IN THE SUPERIOR COURT FOR DURHAM COUNTY, NORTH CAROLINA

APRIL-MAY CIVIL TERM

FOURTEENTH JUDICIAL DISTRICT

W. HANCE HOFLER, TRUSTEE IN BANKRUPTCY FOR AUBREY H. MICHAEL AND EDWARD L. EMBREE, JR., INDIVIDUALLY, AND TRADING AS MICHAEL & EMBREE, CONTRACTORS

v.

G. T. MCARTHUR AND R. L. CHAMBERS, ORIGINAL DEFENDANTS, AND GEORGE H. CARTER, JR., TRADING AS THE DIXIE CONCRETE SUPPLY COMPANY; DURHAM LUMBER COMPANY, INC., ET AL.

JUDGMENT—May 22, 1957

THIS CAUSE coming on to be heard before His Honor Clawson L. Williams, Judge Presiding over the Superior Court for the Fourteenth Judicial District at Durham, and being heard upon the return of the order to show cause entered in this case by the undersigned Clawson L. Williams, Judge Presiding over and holding the Courts for the Fourteenth Judicial District on the 3rd day of May, 1957 which Order to show cause was returnable before the undersigned at the Court House in Durham on the 20th day of May, 1957, at 2:30 o'clock, P. M.; and it appearing to the Court that pursuant to the said Order to show cause the matter did come on for hearing and was heard on this the 20th day of May, 1957, at 2:30 o'clock, P. M., at the Court House in Durham, where and when there were present Daniel K. Edwards, Esq., attorney for the plaintiff in this action; A. L. Purrington, Jr., Esq., attorney for Interpleaded Defendant, Noland Company, Inc., J. W. Bailey, Jr., attorney for Interpleaded Defendant, Peden Steel Co., Arthur Vann, Esq., attorney for Interpleaded Defendant, George H. Carter, Jr., trading as the Dixie Concrete Supply

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Company, Claude V. Jones, Esq., attorney for the Original Defendants, G. T. McArthur and R. L. Chambers, and G. T. McArthur and R. L. Chambers, in person; and it appearing to the Court that the Plaintiff filed a written Motion to strike out and dismiss the Supplemental Answer and Bill of Interpleader filed by the Original Defendants, G. T. McArthur and R. L. Chambers, and George H. Carter, Jr., trading as Dixie Concrete Supply Company and Carolina Steel & Iron Co., filed written Answers to the Supplemental Answer and Bill of Interpleader as appear in the record; and this matter having been heard before the undersigned upon the supplemental [fol. 24b] answer and bill of Interpleader, treated as an affidavit, and upon the Answers filed and arguments of counsel; and after fully hearing and considering the pleadings, and admissions and arguments of counsel the Court finds:

1. That the defendant, G. T. McArthur and R. L. Chambers, entered into a written Contract with Aubrey H. Michael and Edward L. Embree, Jr., individually, and trading as Michael & Embree, Contractors, under date of May 7, 1954, by the terms of which contract the said Michael & Embree agreed to furnish all labor, materials, and services and complete the construction of certain buildings and other improvements on a tract of land in Orange County owned by the Defendant, G. T. McArthur, and all extras to be included therein and furnished thereto, for the total aggregate sum of $20,500.00.

2. That the said McArthur and Chambers paid to said Michael & Embree $15,000.00 on said Contract price and price for extras agreed upon, and subsequent to such payment the said Michael & Embree were placed into bankruptcy and the Plaintiff, Hofler, is Trustee in Bankruptcy for them.

3. That a dispute arose as to the balance due Michael & Embree under the Above mentioned building Contract, the defendants McArthur and Chambers claiming that Michael & Embree had not constructed the buildings and improvements contemplated under the terms of the Contract in accordance with Plans and Specifications therefor, and had in several particulars failed and refused to carry out the Contract in accordance with its terms

and thereby the said McArthur and Chambers had been damaged and that the amount of the damage sustained by them by virtue of the alleged acts and omissions of the contractors was in excess of the balance which was otherwise due by McArthur and Chambers to the Contractors under the terms of said contract; that the plaintiff, Hofler as trustee in bankruptcy, instituted this action against McArthur and Chambers for the recovery of the amount of $9,695.71, alleging that said sum was the balance due after crediting the payment of $15,000, which sum sued for is the same amount as set out and alleged to be due in Exhibit "A" of a Notice of Lien filed in Orange County by Michael & Embree, Contractors, against the defendants, McArthur and Chambers, on the 14th day of January, 1955; that said action was tried in the Superior Court of Durham County at the June 1956 Civil Term, at which time the Jury fixed the amount of the unpaid balance under the contract between Michael & Embree and McArthur and Chambers for all improve-[fol. 24c] ments and extras as $5,250, as set out in the said Judgment signed by the Court; that said Judgment was duly docketed in the Office of the Clerk of the Superior Court of Durham County and a transcript thereof was also docketed in the Office of the Clerk of the Superior Court of Orange County.

4. After the defendants, McArthur and Chambers, had paid to the contractors, Michael & Embree, the sum of $15,000 on said Contract and the price for extras agreed upon, and before the said McArthur and Chambers paid the said $5,250 established by the Jury's verdict and set forth in the Judgment signed at June 1956 Civil Term in this action as being the full balance due on said Contract and contract for extras, certain persons and corporations filed written notices with the said McArthur and Chambers claiming that certain materials furnished by them to Michael & Embree, Contractors, had not been paid for by the said Michael & Embree and some of said persons and corporations further notified the said McArthur and Chambers to retain a sufficient amount out of any balance which might be due under said contract with the contractors for the purpose of paying the said claims of these materialmen; that, as set out above, Michael & Embree

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filed a Notice of Lien in the office of the Clerk of the Superior Court of Orange County on or about the 14th day of January, 1955, in which they listed the names of certain laborers and materialmen who they claimed had furnished labor and materials as set out in said Notice of Lien.

5. McArthur and Chambers are ready and able to pay the balance of $5250 and interest to this date and the costs of the Court accrued to this date, but if they do so without having made as parties to this action the materialmen and laborers who claimed to have furnished materials and labor to Michael & Embree for said project they might not be protected by such payment, and, therefore, the said materialmen and laborers listed as interpleaded defendants are proper and necessary parties for a complete determination of the matters set forth in the Bill of Interpleader in order to be bound by the decision of this Court, and in Order to prevent a multiplicity of suits.

6. That an Involuntary Petition in Bankruptcy was filed in the U. S. District Court for the Middle District of North Carolina against Michael & Embree on the 3rd day of January, 1955, and the U. S. District Judge entered an Order on the 16th day of January, 1955, formally adjudicating said Michael & Embree as Bankrupts. Thereafter W. Hance Hofler was elected Trustee in Bankruptcy of said Michael and Embree, Contractors and is now acting in that capacity.

7. The Plaintiff in this action caused an execution to [fol. 24d] issue upon the judgment obtained by him against McArthur and Chambers and the Sheriff of Durham County now has said Execution and had threatened to levy upon and sell the property of the said McArthur and Chambers in satisfaction of such Execution, and will do so unless permanently restrained by the Court, resulting in irreparable damage to the defendants G. T. McArthur and R. L. Chambers.

Upon the foregoing findings the Court is of the opinion that:

1. The referee in bankruptcy has jurisdiction to determine priorities as between the various claims to or against the fund of $5250 represented by the Judgment

recovered in this action of Hofler, Trustee in Bankruptcy against G. T. McArthur and R. L. Chambers, and the priority of such claims of such persons, firms, and corporations will have to be worked out in such Bankruptcy Court.

2. The said material furnishers and laborers who furnished materials and labor to Michael & Embree and who gave Notice of their claims to McArthur and Chambers after said McArthur and Chambers had paid $15,000 on the contract price and price for extras and prior to the payment by them of the Judgment of $5250 have no claim of any kind against G. T. McArthur and R. L. Chambers, and no claims or liens upon any of their property, other than such rights and claims as they may have in and to the fund of $5250 represented by the payment of the Judgment recovered by Hofler, Trustee, against McArthur and Chambers in this action, the amounts and priorities of such rights and claims in and to said fund to be determined in the Bankruptcy Court, as heretofore stated.

3. The Motion to strike, filed by the plaintiff, should be overruled.

4. The defendant, McArthur and Chambers, are entitled to the relief prayed for in their Supplemental Answer and Bill of Interpleader, except to the extent as otherwise provided in the Judgment.

5. The Notices of Lien appearing upon the Lien Docket in the Office of the Clerk of the Superior Court of Orange County in behalf of Michael & Embree as claimants in one Notice and R. D. Adams, F. H. Adams, P. F. Adams, Jr., and J. D. Adams, trading and doing business as Adams Concrete Products Company as claimants in the other notices constitute encumbrances of record and clouds upon the title of all of the real estate owned by the said defendant G. T. McArthur, which is described and referred to in the said respective Notices and Claims of Lien, and such encumbrances and clouds should be removed from the record.

[fol. 24e] NOW, THEREFORE, IT IS ORDERED, ADJUDGED AND DECREED by the Court:

1. That the said McArthur and Chambers pay to the Plaintiff, W. Hance Hofler, trustee in bankruptcy for Aubrey H. Michael and Edward L. Embree, Jr., individ-

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ually and trading as Michael & Embree, Contracts, the sum of $5250 with interest thereon from the date the said Judgment was docketed in the Office of the Clerk of the Superior Court of Durham County, and computed to the date of the signing of this Judgment; and that they pay to the Clerk of the Superior Court of Durham County the Court costs which have accrued in this action to this date; said G. T. McArthur and R. L. Chambers being hereby fully authorized to use the check signed by G. T. McArthur payable to cash in the sum of $5700 and certified by the bank, which check was deposited by the said McArthur and Chambers with the Clerk of the Superior Court of Durham County as security for the Stay Bond which was filed herein; and the Clerk of the Superior Court of Durham County is hereby fully authorized and directed to surrender and deliver the said check to the said McArthur and Chambers so that they may use the proceeds therefrom to pay the principal of said Judgment and the interest and cost computed as herein specified.

2. Upon the payment by the said McArthur and Chambers to the said W. Hance Hofler, Trustee in Bankruptcy, of the said Judgment and interest computed thereon to the date of this Judgment, and to the Clerk of the Superior Court of the Court costs accruing to the date of this Judgment, the said Judgment shall be ordered cancelled of record, and the said Trustee in Bankruptcy is hereby directed to cancel the said Judgment of record.

3. Upon the payment of said Judgment by the said McArthur and Chambers, as herein specified, the Execution in the hands of the Sheriff of Durham County shall be returned by the said Sheriff of Durham County to the Clerk of the Superior Court of Durham County and be considered null and void.

4. Upon the payment of said Judgment by McArthur and Chambers to the Trustee in Bankruptcy, as herein specified, the said W. Hance Hofler, Trustee in Bankruptcy, is ordered and directed to cause to be cancelled of record the judgment or transcript of judgment in this case which was docketed in the Office of the Clerk of the Superior Court of Orange County, and to also cancel of record the Notice of claim of Lien filed by Michael &

Embree against McArthur and Chambers in the Office of the Clerk of the Superior Court of Orange County.

[fol. 24f] 5. Upon the payment of said judgment of W. Hance Hofler, trustee in bankruptcy, against McArthur and Chambers, as herein specified, the Notice and claim of lien filed by Adams Concrete Products Co., against the defendants, McArthur and Chambers, in the office of the Clerk of the Superior Court of Orange County, is hereby ordered cancelled of record, and the said Impleaded Defendants, Adams Concrete Products Co., are hereby ordered and directed to cause the record of said Notice and Claim of Lien to be marked cancelled of record, and the Clerk of the Superior Court of Orange County is hereby authorized and directed to make an entry upon the Lien Docket in his office that said Notice and Claim of Lien has been directed and ordered to be marked cancelled of record.

6. Upon the payment of said Judgment of Hofler, Trustee, in Bankruptcy, against McArthur and Chambers, the Impleaded defendants, Adams Concrete Products Co., and their attorney and agents are permanently enjoined and restrained from proceeding further with the trial of the institution of any further proceedings in Orange Superior Court in the case of Adams Concrete Products Co., against the said defendants, McArthur and Chambers, and the said Adams Concrete Products Co., and their attorneys are ordered and directed to have said action dismissed from the docket as in case of non-suit.

7. Upon the payment of said Judgment of Hofler, Trustee in Bankruptcy against McArthur and Chambers, the Impleaded defendant, Noland Company, Inc., and its attorneys and agents, are permanently enjoined and restrained from bringing to trial or taking any further proceedings in the Wake Superior Court in the action instituted by Noland Co., Inc., against the defendants, G. T. McArthur and R. L. Chambers, and said Noland Co., Inc., and its attorneys are hereby ordered and directed to have the said action dismissed from the docket as in case of non-suit.

8. That upon payment of said Judgment of Hofler, Trustee in Bankruptcy against McArthur and Chambers, as herein specified, all of the Impleaded Defendants

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named in this action be and they are hereby enjoined and forever and permanently restrained and barred from instituting any actions, claims, suits or proceedings, against the defendants, G. T. McArthur and R. L. Chambers, or either of them or their heirs and assignes, on account of any claims or demands for labor, materials, or services allegedly furnished by any of said persons, firms, and corporations to Michael & Embree, Contractors, and allegedly used in the construction of the improvements on the property of G. T. McArthur referred to in [fol. 24g] this action; and the payment of said sum of $5250, plus interest computed to the date of this judgment and costs accruing in this action to the date hereof, as herein directed by the Court, is hereby adjudged to be in full satisfaction, settlement, exoneration, and discharge of all liability of the defendant, G. T. McArthur and R. L. Chambers, to the plaintiff, W. Hance Hofler, Trustee in Bankruptcy for Michael & Embree, to both Aubrey H. Michael and Edward L. Embree, Jr., individually and trading as Michael & Embree, Contractors, and to each and every one of the defendants named and designated in the Supplemental Answer and Bill of Interpleader filed in this proceeding, and their claims and demands and liens, if any, are hereby transferred to the said fund of $5250 and interest thereon computed as herein specified, which will be in the hands of the Trustee in Bankruptcy, and their equities, claims, and priorities shall be worked out in said fund in accordance with the orders and directions of the Bankruptcy Court.

9. The Motion to Strike from the Supplemental Answer and Bill of Interpleader is hereby overruled.

Entered this the 22nd day of May, 1957.

(Signed) Clawson L. Williams
Judge presiding over and holding the Superior Court for the Fourteenth Judicial District

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[fol. 25] IN THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 7619

UNITED STATES OF AMERICA, APPELLANT

v.

DURHAM LUMBER COMPANY, a corporation, and GEORGE H. CARTER, JR., formerly trading as DIXIE CONCRETE AND SUPPLY COMPANY, APPELLEES

In the Matter of

Aubrey H. Michael & Edward L. Embree, Jr.,
Ind. and T/A Michael & Embree,
Contractors, Bankrupt.

Appeal from the United States District Court for the Middle District of North Carolina, at Greensboro.

DOCKET ENTRIES

February 7, 1958, record on appeal filed and appeal docketed.

February 7, 1958, order of Johnson J. Hayes, United States District Judge, extending the time to and including the 6th day of February, 1958, within which to file the record and docket cause in the United States Court of Appeals for the Fourth Circuit, filed.

February 7, 1958, appearance of Charles K. Rice, Assistant Attorney General, and Lee A. Jackson, Attorney, Department of Justice, entered for the United States.

February 11, 1958, appearance of Arthur Vann entered for the appellee George H. Carter, Jr., formerly trading as Dixie Concrete and Supply Company.

February 12, 1958, appearance of Robert L. Gavin, United States Attorney, and Lafayette Williams, Assistant United States Attorney, entered for the appellant.

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February 13, 1958, appearance of Daniel M. Williams, Jr., entered for the appellee Durham Lumber Company, a corporation.

[fol. 26] March 8, 1958, appearance of Charles K. Rice, Assistant Attorney General, Lee A. Jackson, A. F. Prescott and Louise Foster, Attorneys, Department of Justice, entered for the claimant-appellant.

March 8, 1958, brief and appendix for the claimant-appellant filed.

March 25, 1958, brief and appendix for the claimant-appellees filed.

MINUTE ENTRY OF ARGUMENT AND SUBMISSION—
April 15, 1958

(Omitted in printing)

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[fol. 27] IN UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 7619

UNITED STATES OF AMERICA, APPELLANT

v.

DURHAM LUMBER COMPANY, a corporation, and GEORGE H. CARTER, JR., formerly trading as DIXIE CONCRETE AND SUPPLY COMPANY, APPELLEES

In the Matter of Aubrey H. Michael & Edward L. Embree, Jr., Ind. and T/A Michael & Embree, Contractors, Bankrupt.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF NORTH CAROLINA, AT GREENSBORO.

Argued April 15, 1958.

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Before SOBELOFF, Chief Judge, HAYNSWORTH, Circuit Judge, and PAUL, District Judge.

Louise Foster, Attorney, Department of Justice, (Charles K. Rice, Assistant Attorney General; Lee A. Jackson [fol. 28] and A. F. Prescott, Attorneys, Department of Justice; Robert L. Gavin, United States Attorney, and Lafayette Williams, Assistant United States Attorney, on brief) for Appellant; Arthur Vann for George H. Carter, Jr., etc., Appellee; and Daniel M. Williams, Jr., for Durham Lumber Co., Appellee.

OPINION—decided July 18, 1958

HAYNSWORTH, Circuit Judge:

This appeal presents a question of the relative rights of the United States, claiming under a tax lien upon the

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properties of a general contractor, and certain subcontractors, claiming in their individual rights against the owners of improved real estate. The District Court held, we think properly, that the subcontractors had the prior right in the particular fund.

Michael & Embree, general contractors, completed certain construction work in July 1954, but the owners disputed the amount of the balance due under the construction contract. Shortly thereafter, uncollected taxes were assessed to the general contractor, upon the basis of which a lien arose, in favor of the United States, upon all of the general contractor's property and rights to property. Internal Revenue Code of 1954, § 6321 (26 USCA § 6321). Later, certain subcontractors, who had not been paid, filed with the owners notices of their claims pursuant to the provisions of the General Statutes of North Carolina, § 44-9. Meanwhile, the general contractor-taxpayer had filed a petition in bankruptcy.

The Trustee in Bankruptcy brought an action against the owners for the balance claimed to be due on the con- [fol. 29] struction contract and obtained a judgment in the Superior Court for Durham County, North Carolina, for $5,250.00. The owners thereupon petitioned the Bankruptcy Court for permission to satisfy the judgment, *pro tanto,* by paying subcontractors and materialmen who had filed appropriate notices with them. As a result of extensive negotiations in which the subcontractors participated, the parties agreed to petition the Superior Court to reopen the case there, join the subcontractors as parties and enter an order which would permit the owners to pay to the Trustee the balance due, without prejudice to the rights of the subcontractors in the fund. An appropriate order was entered purporting to preserve the claims and rights of the subcontractors but substituting as the obligor the fund in the hands of the Trustee in the stead of the owners and their improved property.

The Government frankly states that it was understood that the conflicting rights of all parties would be determined in the Bankruptcy Court as if the matter, with all proper parties, was still in the state court. We, thus, need not be concerned with the subsequent procedures, but are required to consider the conflicting claims of the United States and the subcontractors as if the owners had

continued to withhold payment of the amount of the judgment.

The Referee concluded, as a matter of law, that the rights of the United States under its tax lien were superior to those of the subcontractors. The District Judge disagreed and, accordingly, modified the order of the Referee.

There is no doubt of the priority of the Federal tax lien over a mechanic's lien when the two liens attach to the same property. A mechanic's lien is not one of those [fol. 30] preferred interests to which the Congress has extended priority over the tax lien. Internal Revenue Code of 1954, § 6323 (26 USCA § 6323). *United States* v. *White Bear Brewing Co., Inc.*, 350 U. S. 1010, 76 S. Ct. 646, 100 L. Ed., 871. If the owner, rather than the general contractor, had been the delinquent taxpayer, the Federal tax lien reaching all of the owner's property, would outrank the claims of subcontractors, whether or not those claims had been protected with perfected mechanic's liens. It is equally clear that any claims of the subcontractors against the general contractor-taxpayer are subordinate to the tax lien attaching to all of the general contractor's property. But we are confronted with a different situation, one which calls for an examination of the nature of the right of the subcontractor, as asserted in North Carolina, against the owner of the improved property.

Prior to 1874, the statutes of North Carolina provided a lien upon improved real estate to secure the payment of "all debts contracted for work done on the same, or material furnished." Preservation of the lien was contingent upon a timely filing of a notice in the office of the Clerk of the Superior Court and a timely institution of an action to enforce the lien. This is still the statutory scheme for the protection of the rights of general contractors. General Statutes of North Carolina, §§ 44-1, 44-38, 44-39, 44-40, 44-43.

In 1874, however, it was held in *Wilkie* v. *Bray*, 71 N. C. 205, that the statute created liens only for the benefit of persons in privity of contract with the owner and that no lien was created for the protection of a subcontractor. This decision led to a series of new statutes conferring new rights upon subcontractors and creating

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new interests for their protection. See *Morganton Mfg.* [fol. 31] *& Trading Co.* v. *Anderson*, 165 N. C. 285, 81 S. E. 418; *Lester* v. *Houston*, 101 N. C. 605, 8 S. E. 366; *Charlotte Pipe & Foundry Co.* v. *Southern Aluminum Co.*, 172 N. C. 704, 90 S. E. 923.

The statutes adopted after 1874, expressly created a lien for the protection of subcontractors which is preferred to that arising in favor of the general contractor.[1] The general contractor, before receiving any payment from the owner, is required to file with the owner a statement of all sums due subcontractors, and the owner is directed to pay such sums directly to the subcontractors rather than to the general contractor.[2] A contractor who fails to furnish such a statement is guilty of a misdemeanor,[3] but, whether he does or not, a subcontractor may furnish the owner with a statement of his account. If he does so, a lien immediately arises in his favor, and, thereafter, no "payment to the contractor shall be a credit on or a discharge of the lien * * *."[4] The requirement that notice of the lien be filed in the office of the Clerk of the Superior Court is made inapplicable, notice to the owner being all that is required.[5] The lien, as an interest in the real estate of the owner, is extinguished if the subcontractor does not commence an action to enforce it within six months after the notice,[6] but the requirement that the owner make payment to the subcontractor in preference to the general contractor remains in effect, and the subcontractor may maintain an action against [fol. 32] the owner, at any time within the period of general limitations, to compel compliance with that duty.[7]

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[1] General Statutes of North Carolina, § 44-6.

[2] General Statutes of North Carolina, § 44-8.

[3] General Statutes of North Carolina, § 44-12.

[4] General Statutes of North Carolina, § 44-9.

[5] General Statutes of North Carolina, § 44-10.

[6] *Hildebrand* v. *Vanderbilt*, 147 N. C. 639, 61 S. E. 620.

[7] *Hildebrand* v. *Vanderbilt*, 147 N. C. 639, 61 S. E. 620; *Charlotte Pipe & Foundry Co.* v. *Southern Aluminum Co.*, 172 N. C. 704, 90 S. E. 923; *Guilford Lumber Mfg. Co.* v. *Holladay*, 178 N. C. 417, 100 S. E. 597; *Campbell* v. *Hall*, 187 N. C. 464, 121 S. E. 761; *Schnepp* v. *Richardson*, 222 N. C. 228, 22 S. E. 2d 555.

It is clear that under the North Carolina statutes the subcontractor who notifies the owner of his claim has (1) a lien upon the improved real estate superior to any lien which the general contractor may obtain, and (2) an independent cause of action against the owner, maintainable in his own name and in his own right, without regard to the time limitations upon the commencement of suit to enforce a lien, and the owner, after notice, may not avoid or reduce his direct liability to the subcontractor by any payment to, or settlement with, the general contractor. In any settlement with the general contractor, the owner may take credit for payments made by him to subcontractors, and he is required by statute to withhold sufficient funds to pay all of the claims of subcontractors of which he has notice. The obligation of the owner to the subcontractor is, thus, primary; his obligation to the general contractor, secondary.[8]

The subcontractor also has a claim against the general contractor. If we consider only this aspect of his right and if the subcontractor was proceeding in aid of his right to payment by the general contractor, this case would present no difficulty. The tax lien is clearly entitled to priority over the general claims of subcontrac-[fol. 33] tors seeking payment out of the property or interests in property of the general contractor, to which the tax lien has attached. But to define the right of the general contractor to receive payment of the contract price, subject, as we have seen, to the prior rights of subcontractors, as a property right reached by the tax lien does not convert this case into one of simple solution upon application of the established principle that the tax lien has priority over a mechanic's lien when both attach to the same property. We may not ignore the facts that the tax lien reaches the properties of the general contractor, not those of the owners, and that the independent rights of the subcontractors are asserted against the owners and their properties, not against the taxpayer or its properties. The priority of the tax lien

[8] The limitation that the aggregate of the owner's liabilities to subcontractors may not exceed his contract obligation is of no moment here, for the amount still due by the owners was more than sufficient to pay the outstanding claims of the subcontractors.

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in the division and distribution of the properties of the taxpayer, to which it attaches, is not to be extended to a like priority in the division or distribution of the properties of the taxpayer's debtor, to which the tax lien does not reach. Nor should the tax lien on the properties of the taxpayer extinguish private rights and liabilities as between other persons who do not claim through or in the right of the taxpayer.

As the statutes of North Carolina expressly provide, the owners may not discharge their debt to the subcontractors, of whose claims they have notice, by any payment to the general contractor. This is true whether or not the general contractor reduces his claim to judgment and whether or not the United States, through a tax lien, has become one of the "owners"[9] of the claim of the general contractor. The subcontractors are still entitled to proceed against the owners and to payment of their claims out of the assets of the owners. Should the [fol. 34] owners answer such a suit with a plea in bar that the claim of the general contractor had been acquired by the United States under a tax lien, it would stand on no higher plane than a plea of voluntary payment to the general contractor. Seizure by the United States under a tax lien of the claim of the general contractor cannot extinguish the statutory rights and obligations of a subcontractor and a North Carolina owner as between each other.

This is the right asserted by the subcontractors here. They do not seek payment out of the properties of the general contractor which are subject to the tax lien. Their claims are addressed to the owners. To the extent that the owners may be allowed to take credit for the amount of their claims in any settlement with the general contractor, the existence of the claims are relevant to an appraisal of the worth of the claim of the general contractor. That is a consequence of the nature of the rights as created and limited by the statutes, but it does not force the subcontractor to look to the assets of the general contractor, rather than to those of the owner, for satisfaction of his claim. Nor does it permit us to deny

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[9] *United States* v. *City of Greenville*, 4 Cir., 118 F. 2d 963, 965.

enforcement of the subcontractors' statutory rights against solvent owners. At the most, it can mean only that, except to the extent the claim of the general contractor exceeds the aggregate of the claims of the subcontractors, the general contractor has no right which is subject to seizure under the tax lien.

That was the conclusion of the Court of Appeals for the Second Circuit in Fidelity and Deposit Company of Maryland v. New York City Housing Authority, 2 Cir., 241 F. 2d 142. There it was carefully pointed out that it is a federal function, in applying federal revenue laws, to classify state-created rights and interests and to de-[fol. 35] termine their relative priorities, but the rights and interests themselves are creatures of the state. If the delinquent taxpayer has no right under state laws, there is nothing upon which the tax lien may attach. The court there found that the provisions of the general construction contract, under the laws of New York, created a preference for the claims of subcontractors, asserted against the owner, over those of the general contractor-taxpayer, and, therefore, concluded that the general contractor-taxpayer had no right which the tax lien could reach. The more decided preference, under the laws of North Carolina, of the claims of the subcontractors leads us to the same conclusion.

The only question recognized as being before the court in the earlier case of *United States* v. *Kings County Iron Works*, 2 Cir., 224 F. 2d 232, was the one of relative priority of competing claims to the same fund. In such a contest, the tax lien must always be the victor over the claims of subcontractors. Later, however, when the very different situation with which we are confronted was clearly presented to the same court in the Fidelity and Deposit case, it was recognized that the tax lien may prevail over the claims of subcontractors only when they compete for recognition in the same property or right.

In *Aquilino* v. *United States*, 3 N. Y. 2d 511, 146 N. E. 2d 774, the New York Court of Appeals reached a conclusion apparently at variance with our own. The opinion indicates no awareness of the decision in the Fidelity and Deposit case, but construed Kings County Iron Works

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to stand for the proposition that the tax lien on the property of the general contractor would prevent the assertion of the rights of subcontractors against the owner. Had the New York Court of Appeals been informed of the decision of the Court of Appeals for the [fol. 36] Second Circuit in Fidelity and Deposit, indeed had it felt at liberty to accord full recognition to the state-created right of the subcontractor against the owner, it may have reached a different conclusion.

That the Court of Appeals of New York should have accorded greater recognition to the state created rights is strongly indicated by the very recent case of United States v. Bess, —— U. S. ——, —— S. Ct. ——, —— L. Ed. —— (decided June 9, 1958) in which it was held that the tax lien could attach only to such rights as had been created and limited by state law. Section 3670, it was said, merely attaches federally defined consequences to state created rights. In stating the proposition, the Supreme Court cited with approval the decision of the Court of Appeals for the Second Circuit in *Fidelity and Deposit, supra.* Had the New York Court of Appeals adopted the same approach in *Aquilino,* it hardly could have avoided the conclusion that where the state created right of the general contractor was at all times secondary and subordinate the attachment of the Tax lien does not elevate it to a status of primacy and preference.

The rights of the subcontractors as here asserted against the owners are not liens. Each of them acquired a lien on the real estate of the owner when he gave notice of his claim, but no one of them instituted an action to foreclose the lien within six months after the notice, and they may not now do so. But their statutory right to payment by the owners persists and may be enforced by them. Their claims are preferred to that of the general contractor, but, with respect to others, their standing is that of a common creditor of the owners. But theirs is a valuable right which is not extinguished by the tax lien on the property of the general contractor, whose only claim against the owners under [fol. 37] the laws of North Carolina, is for so much of the construction price as will remain unpaid after the

owners have deducted a sum sufficient to pay the subcontractors.

We agree with the District Judge that the balance of the construction price should be applied first to payment in full of the claims of the subcontractors, and then only may the remainder be disbursed as an asset of the bankrupt estate.

Affirmed.

[fol. 38] • • • •

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[fol. 39] IN UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 7619

UNITED STATES OF AMERICA, APPELLANT

v.

DURHAM LUMBER COMPANY, a corporation, and GEORGE H. CARTER, JR., formerly trading as DIXIE CONCRETE AND SUPPLY COMPANY, APPELLEES

In the Matter of

Aubrey H. Michael & Edward L. Embree, Jr.,
Ind. and T/A Michael & Embree,
Contractors, Bankrupt.

APPEAL FROM the United States District Court for the Middle District of North Carolina.

JUDGMENT—Filed and Entered July 18, 1958

THIS CAUSE came on to be heard on the record from the United States District Court for the Middle District of North Carolina, and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered, adjudged and decreed by this Court that the order of the said District Court appealed from, in this cause, be, and the same is hereby, affirmed.

SIMON E. SOBELOFF
Chief Judge, Fourth Circuit.

CLEMENT F. HAYNSWORTH, JR.
United States Circuit Judge.

JOHN PAUL
United States District Judge.

August 19, 1958, mandate issued and transmitted to the Clerk of the United States District Court at Greensboro, North Carolina.

August 19, 1958, record on appeal returned to the Clerk of the United States District Court at Greensboro, North Carolina.

(File Endorsement Omitted)

[fol. 40] Clerk's Certificate to foregoing transcript omitted in printing.

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[fol. 41] SUPREME COURT OF THE UNITED STATES

(Title omitted)

ORDER EXTENDING TIME TO FILE PETITION FOR WRIT OF CERTIORARI—October 10, 1958

UPON CONSIDERATION of the application of counsel for petitioner,

IT IS ORDERED that the time for filing petition for writ of certiorari in the above-entitled cause be, and the same is hereby, extended to and including December 15th, 1958.

/s/ Earl Warren
Chief Justice of the United States

Dated this 10th
day of October, 1958.

[fol. 42] SUPREME COURT OF THE UNITED STATES

No. 579, October Term, 1958

(Title omitted)

ORDER ALLOWING CERTIORARI—February 24, 1959

The petition herein for a writ of certiorari to the United States Court of Appeals for the Fourth Circuit is granted. The case is transferred to the summary calendar and assigned for argument immediately following No. 132.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

☆ U. S. GOVERNMENT PRINTING OFFICE, 1959 506184 1478

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